

(iv) For the computation of the capital gains item of tax preference in the case of an electing small business corporation (as defined in section 1371(b)), see § 1.58-4(c).

(3) *Nonresident aliens, foreign corporations.* In the case of a nonresident alien individual or foreign corporation, there shall be included in computing the capital gains item of tax preference under section 57(a)(9) only those capital gains and losses included in the computation of income effectively connected with the conduct of a trade or business within the United States as provided in section 871(b) or 882.

[T.D. 7564, 43 FR 40470, Sept. 12, 1978]

§§ 1.57-2—1.57-3 [Reserved]

§ 1.57-4 Limitation on amounts treated as items of tax preference for taxable years beginning before January 1, 1976.

(a) *In general.* If in any taxable year beginning before January 1, 1976, a taxpayer has deductions in excess of gross income and all or a part of any item of tax preference described in § 1.57-1 results in no tax benefit due to modifications required under section 172(c) or section 172(b)(2) in computing the amount of the net operating loss or the net operating loss to be carried to a succeeding taxable year, then, for purposes of section 56(a)(1), the sum of the items of tax preference determined under section 57(a) (and § 1.57-1) is to be limited as provided in paragraph (b) of this section.

(b) *Limitation.* The sum of the items of tax preference, for purposes of section 56(a)(1) and § 1.56A-1(a), is limited to an amount determined under subparagraphs (1) and (2) of this paragraph.

(1) *Loss year.* If the taxpayer has no taxable income for the taxable year without regard to the net operating loss deduction, the amount of the limitation is equal to—

(i) In cases where the taxpayer does not have a net operating loss for the taxable year, the amount of the recomputed income (as defined in paragraph (c) of this section) or

(ii) In cases where the taxpayer has a net operating loss for the taxable year, the amount of the net operating loss

(expressed as a positive amount) increased by the recomputed income or decreased by the recomputed loss for the taxable year (as defined in paragraph (c) of this section,

plus the amount of the taxpayer's stock option item of tax preference (as described in § 1.57-1(f)).

(2) *Loss carryover and carryback years.* Except in cases to which subparagraph (1)(ii) of this paragraph applies, if, in any taxable year to which a net operating loss is carried, a capital gains deduction is disallowed under section 172(b)(2) in computing the amount of such net operating loss which may be carried to succeeding taxable years, the amount of the limitation is equal to the amount, if any, by which the sum of the items of tax preference (computed with regard to subparagraph (1)(i) of this paragraph) exceeds the lesser of—

(i) The amount by which such loss is reduced because of a disallowance of the capital gains deduction in such taxable year, or

(ii) The capital gains deduction.

The amount determined pursuant to the preceding sentence shall be increased by the amount, if any, that such reduction is attributable to that portion of such a net operating loss described in section 56(b)(1)(B) and § 1.56A-2(a)(2) (relating to excess tax preferences).

(c) *Recomputed income or loss.* For purposes of this section, the phrase "recomputed income or loss" means the taxable income or net operating loss for the taxable year computed without regard to the amounts described in § 1.57-1 except paragraph (i)(2) of that section (relating to corporate capital gains) and without regard to the net operating loss deduction. For this purpose, the reference to the amounts described in § 1.57-1 is a reference to that portion of the deduction allowable in computing taxable income under the appropriate section equal to the amount which is determined in each paragraph of § 1.57-1. For example, the amount described in § 1.57-1(h) (relating to excess of percentage depletion over basis) is that portion of the deduction allowable for depletion under section 611 which is equal to the amount determined under § 1.57-1(h). For purposes of

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this paragraph, the amount described in § 1.57-1(i)(1) (relating to capital gains) is to be considered as the amount of the deduction allowable for the taxable year under section 1202.

(d) *Determination of preferences reduced.* When, pursuant to paragraph (b)(1) of this section, the sum of the items of tax preference (determined without regard to this section) are reduced, such reduction is first considered to be from the capital gains item of tax preference (described in § 1.57-1(i)(1)) and each item of tax preference relating to a deduction disallowed in computing the net operating loss pursuant to section 172(d), pro rata. The balance of the reduction, if any, is considered to be from the remaining items of tax preference, pro rata. For purposes of this subparagraph, deductions not attributable to the taxpayer's trade or business which do not relate to items of tax preference are considered as being applied in reducing gross income not derived from such trade or

business before such deductions which do relate to items of tax preferences.

(e) *Examples.* The principles of this section may be illustrated by the following examples in each of which the deduction for the personal exemption is disregarded and the taxpayer is an individual who is a calendar year taxpayer.

Example 1. The taxpayer has the following items of income and deduction for 1970:

| | |
|--|-----------|
| Gross income (all business income) | \$120,000 |
| Deductions: | |
| Nonbusiness deductions | 30,000 |
| Items of tax preference (excess accelerated depreciation on real property held in taxpayer's business) | 80,000 |
| Other business deductions | 50,000 |

Based on the above figures, the taxpayer has a net operating loss of \$10,000 (business deductions of \$130,000 less business income of \$120,000, the nonbusiness deductions having been disallowed by reason of section 172(d)(4)). The limitation on the amount treated as items of tax preference is computed as follows:

| | |
|---|-----------|
| Tax preferences | \$80,000 |
| Net operating loss | \$10,000 |
| Recomputed income or loss: | |
| Gross income | \$120,000 |
| Deductions other than tax preference items | 80,000 |
| Recomputed income | 40,000 |
| Sum of net operating loss and recomputed income | 50,000 |
| Stock options preference | 0 |
| Limitation | 50,000 |

Thus, the minimum tax computed under section 56(a) would be 10 percent of \$20,000 (items of tax preference of \$50,000 less the minimum tax exemption of \$30,000), \$1,000 of which would be deferred tax liability pursuant to section 56(b).

Example 2. Assume the same facts as in example 1 except that the other business deductions are \$130,000, resulting in a net operating loss of \$90,000. The limitation on the amount treated as items of tax preference is computed as follows:

| | |
|--|-----------|
| Tax preferences | \$80,000 |
| Net operating loss | \$90,000 |
| Recomputed income or loss: | |
| Gross income | \$120,000 |
| Deductions other than tax preference items | 160,000 |
| | (40,000) |
| Disallowance of nonbusiness deductions under sec. 172(d) | 30,000 |
| Recomputed loss | 10,000 |
| Net operating loss less recomputed loss | 80,000 |
| Stock options preference | 0 |
| Limitation | 80,000 |

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Thus, the minimum tax computed under section 56(a) would be 10 percent of \$50,000 (items of tax preference of \$80,000 less the minimum tax exemption of \$30,000), all of

which will be deferred tax liability pursuant to section 56(b).

Example 3. The taxpayer has the following items of income and deduction for 1970:

| | | |
|---|----------|----------|
| Gross income (all from business): | | |
| Ordinary | | \$50,000 |
| Net section 1201 gains | | 120,000 |
| Deductions: | | |
| Items of tax preference: | | |
| Excess amortization of certified pollution control facilities | \$45,000 | |
| Capital gains deduction | 60,000 | 105,000 |
| | | ----- |
| Other business deductions | | 75,000 |

In addition, the taxpayer has a \$55,000 item of tax preference resulting from qualified stock options. Based on the above figures, the taxpayer has no taxable income and no net operating loss as the capital gains deduc-

tion is disallowed in determining the net operating loss pursuant to section 172(d). The limitation on the amount treated as items of tax preference is computed as follows:

| | | |
|--|-----------|-----------|
| Tax preferences | | \$160,000 |
| Net operating loss | | 0 |
| Recomputed income or loss: | | |
| Gross income | \$170,000 | |
| Deductions other than tax preference items | 75,000 | |
| | | ----- |
| Recomputed income | | \$95,000 |
| Plus: Stock options preference | | 55,000 |
| | | ----- |
| Limitation | | 150,000 |

Thus, the minimum tax computed under section 56 would be 10 percent of \$120,000 (items of tax preference of \$150,000 less the minimum tax exemption of \$30,000).

Thus, the minimum tax computed under section 56 would be 10 percent of \$70,000 (items of tax preference of \$100,000 less the minimum tax exemption of \$30,000).

Example 4. Assume the same facts as in example (3) except that the taxpayer has a net operating loss carryover from 1969 of \$80,000. The taxpayer has \$160,000 of tax preferences which are limited to \$150,000 pursuant to §1.57-4(b)(1). In order to determine the amount of the 1969 net operating loss which remains as a carryover to 1971, the 1970 taxable income is redetermined in accordance with section 172(b)(2) and the regulations thereunder, as follows:

Example 5. The taxpayer has the following items of income and deduction for the taxable year 1970 without regard to any net operating loss deduction:

| | | |
|--|-----------|---------|
| Gross income—1970 | \$170,000 | |
| Deductions: | | |
| Capital gains deduction disallowed business deductions | \$120,000 | 120,000 |
| | | ----- |
| Taxable income for section 172(b)(2) ... | | 50,000 |

| | | |
|---|----------|----------|
| Gross income (all from business): | | |
| Ordinary | \$50,000 | |
| Net section 1201 gain | 40,000 | |
| | | ----- |
| | | \$90,000 |
| Deductions: | | |
| Capital gains deduction | 20,000 | |
| Medical expenses (\$4,100 actually paid but allowable only to the extent in excess of 3 percent of adjusted gross income of \$70,000) | 2,000 | |
| Other itemized deductions | 40,000 | |
| | | ----- |
| | | 62,000 |

Thus, the 1969 net operating loss which remains as a carryover to 1971 is \$30,000. Pursuant to paragraph (b)(2) of this section, the limitation on the amount treated as items of tax preference is computed as follows:

| | |
|--|--------|
| Taxable income (before net operating loss deduction) | 28,000 |
|--|--------|

| | | |
|---|-----------|-------|
| Items of tax preference computed with regard to § 1.57-4(b)(1) (per example (3)) | \$150,000 | |
| Less: Lesser of capital gains deduction (\$60,000) or amount of reduction in carryover due to its disallowance (\$50,000) | 50,000 | |
| | | ----- |
| Limitation | 100,000 | |

In addition, the taxpayer has an item of tax preference of \$35,000 resulting from qualified stock options. In 1973, the taxpayer has a net operating loss of \$60,000 (no portion of which is attributable to excess tax preferences pursuant to §1.56A-2) which is carried back to 1970 resulting in no taxable income in 1970. In order to determine the amount of the 1973

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net operating loss which remains as a carryover to 1971, the 1970 taxable income is redetermined, in accordance with section 172(b)(2) and the regulations thereunder, as follows:

| | |
|---|----------|
| Gross income | \$90,000 |
| Deductions: | |
| Capital gains deduction disallowed. | |
| Medical expenses (\$4,100 actually paid but allowable only to the extent in excess of 3 percent of adjusted gross income of \$90,000) | \$1,400 |
| Other itemized deductions | 40,000 |
| | <hr/> |
| | \$41,400 |
| Taxable income for section 172(b)(2) | 48,600 |

The limitation on the amount treated as items of tax preference is computed as follows:

| | |
|---|----------|
| Items of tax preference: | |
| Capital gains | \$20,000 |
| Stock options | 35,000 |
| | <hr/> |
| | 55,000 |
| Less: | |
| Lesser of capital gains deduction (\$20,000) or amount of reduction in carryover due to its disallowance (\$20,600) | (20,000) |
| Limitation | 35,000 |

Thus, the minimum tax for 1970 under section 56 would be 10 percent of \$5,000 (items of tax preference of \$35,000 less the minimum tax exemption of \$30,000).

Example 6. Assume the same facts as in example (5) except that the 1973 net operating loss was \$45,000. In this case, the \$20,600 increase in the 1970 taxable income as redetermined, results in a decrease of \$17,000 (i.e., the remaining 1973 net operating loss after an initial decrease of \$28,000 resulting from the 1970 taxable income before redetermination). The limitation on the amount treated as items of tax preference is computed as follows:

| | |
|---|----------|
| Items of tax preference computed without regard to this section | \$55,000 |
| Less: Lesser of capital gains deduction (\$20,000) or amount of reduction in carryover due to its disallowance (\$17,000) | (17,000) |
| Limitation | 38,000 |

Thus, the minimum tax for 1970 under section 56 would be 10 percent of \$8,000 (items of tax preference of \$38,000 less the minimum tax exemption of \$30,000).

Example 7. The taxpayer has the following items of income and deduction for 1973 without regard to any net operating loss deduction:

| | |
|-----------------------------------|-----------|
| Gross income (all from business): | |
| Ordinary | \$100,000 |
| Net section 1201 gains | 120,000 |

| | |
|---|-----------|
| | \$220,000 |
| Deductions: | |
| Items of tax preference: | |
| Excess amortization of certified pollution control facilities | 45,000 |
| Capital gains deduction | 60,000 |
| | <hr/> |
| | 105,000 |
| Other business deductions | 75,000 |
| | <hr/> |
| | \$180,000 |
| Taxable income (before net operating loss deduction) | 40,000 |

In 1972, the taxpayer had a net operating loss of \$70,000 which is carried forward to 1973; \$20,000 of this net operating loss is attributable to excess tax preferences. In order to determine the amount of the 1972 net operating loss which remains as a carryover to 1974, the 1973 taxable income is redetermined, in accordance with section 172(b)(2) and the regulations thereunder, as follows:

| | |
|---|------------|
| Gross income | \$220,000 |
| Deductions: | |
| Capital gains deduction | Disallowed |
| Business deductions | 120,000 |
| | <hr/> |
| Taxable income per section 172(b)(2) .. | 100,000 |

In this case, the \$60,000 increase in the 1972 taxable income as redetermined and the \$30,000 decrease in the amount of the 1973 net operating loss remaining as a carryover to 1974 (i.e., the remaining 1972 net operating loss after an initial decrease of \$40,000 resulting from the 1973 taxable income before redetermination) is entirely attributable to the disallowance of the capital gains deduction. The limitation on the amount treated as items of tax preference is computed as follows:

| | |
|--|----------|
| Items of tax preference computed without regard to this section: | |
| Capital gains | \$60,000 |
| Excess amortization of certified pollution control facilities | 45,000 |
| | <hr/> |
| | 105,000 |
| Less: Lesser of capital gains deduction (60,000) or amount of reduction in carryover due to its disallowance (\$30,000) | (30,000) |
| | <hr/> |
| | 75,000 |
| Plus: Amount of reduction of carryover (due to disallowance of capital gains deduction) attributable to excess tax preferences | 20,000 |
| Limitation | 95,000 |

[T.D. 7564, 43 FR 40476, Sept. 12, 1978, as amended by T.D. 8138, 52 FR 15309, Apr. 28, 1987]

§ 1.57-5 Records to be kept.

(a) *In general.* The taxpayer shall have available permanent records of all the facts necessary to determine with